

Entered on Docket

December 20, 2007

GLORIA L. FRANKLIN, CLERK  
U.S. BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA



Signed and Filed: December 17, 2007

A handwritten signature in blue ink that appears to read "T. Carlson".

THOMAS E. CARLSON  
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re ) Case No. 07-30309 TEC

HUGO NERY BONILLA, ) Chapter 7

Debtor. )

ATR-KIM ENG CAPITAL PARTNERS, INC., ) Adv. Proc. No. 07-3079 TC  
and ATR-KIM ENG FINANCIAL )  
CORPORATION, )

Plaintiffs, )

vs. )

HUGO NERY BONILLA, )

Defendant. )

MEMORANDUM RE DEFENDANT'S MOTION FOR RECONSIDERATION AND  
PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

I. Motion for Reconsideration

Defendant seeks reconsideration of the denial of his motion to dismiss Plaintiffs' fourth cause of action for failure to state a claim upon which relief can be granted. In so moving, Defendant

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1 contends that this court made a manifest error of law in  
2 determining that the director of a Delaware corporation is a  
3 "fiduciary" within the meaning of section 523(a)(4) of the  
4 Bankruptcy Code.

5 Defendant first argues that this court did not give proper  
6 deference to the decision of the Ninth Circuit in Cal-Micro, Inc.,  
7 v. Cantrell (In re Cantrell), 329 F.3d 1119 (9th Cir. 2003).  
8 Because Cantrell relied upon a California Supreme Court decision  
9 stating that a corporate officer is an agent rather than a trustee  
10 under California law, I find Cantrell to be of little relevance to  
11 the present case involving a Delaware director.

12 Defendant next argues that the decisions of the Delaware  
13 Supreme Court imposing trustee-like duties on corporate directors  
14 are inapposite because they involved instances in which the  
15 corporation was insolvent or the director improperly benefitted  
16 from the act in question. This argument is unpersuasive for two  
17 reasons.

18 First, Defendant cites no Delaware decision holding that a  
19 corporate director has trustee-like duties *only* where the  
20 corporation is insolvent or the director benefits. At the same  
21 time, a decision of the Delaware Chancery Court imposed trustee-  
22 like duties on corporate directors where there was no showing of  
23 insolvency or improper benefit. Bodell v. General Gas & Electric  
24 Corp., 132 A. 442, 447 (Del. Ch. 1926).

25 Second, a recent decision of the Delaware Supreme Court holds  
26 that the fiduciary duties owed shareholders are the same as those  
27 owed creditors upon insolvency.

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It is well settled that directors owe fiduciary duties to the corporation. When a corporation is solvent, those duties may be enforced by its shareholders, who have standing to bring derivative actions on behalf of the corporation because they are the ultimate beneficiaries of the corporation's growth and increased value. When a corporation is insolvent, however, its creditors take the place of the shareholders as the residual beneficiaries of any increase in value.

Consequently, the creditors of an *insolvent* corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties. The corporation's insolvency "makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value." Therefore, equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation. Individual creditors of an insolvent corporation have the same incentive to pursue valid derivative claims on its behalf that shareholders have when the corporation is solvent.

13 North American Catholic Educational Programming Foundation, Inc.,  
14 v. Gheewalla, 930 A.2d 92, 101-02 (Del. 2007) (emphasis and  
15 quotations in original)(footnotes omitted). In this context, the  
16 Delaware decisions holding that directors become trustees for  
17 creditors upon insolvency become direct support for the conclusion  
18 that directors are trustee for shareholders while the corporation  
19 is solvent.

20 Defendant argues finally that this court erred in relying upon  
21 the "substantially similar" test stated in Lewis v. Scott (In re  
22 Lewis), 97 F.3d 1182 (9th Cir. 1996), asserting that Lewis is an  
23 "anomaly" among Ninth Circuit decisions otherwise interpreting  
24 section 523(a)(4) very narrowly. This court is persuaded that the  
25 functional approach of Lewis is sound. Reliance on formalistic  
26 taxonomy has lead the Ninth Circuit to the somewhat curious  
27 conclusion that a director of a California corporation is a

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1 fiduciary for creditors when the corporation is insolvent,<sup>1</sup> but is  
2 not a fiduciary for the director's prime constituents,  
3 shareholders, when the corporation is not insolvent.<sup>2</sup> North  
4 American Catholic, decided by the court most widely recognized for  
5 its expertise in corporate governance, suggests that a functional,  
6 interest-based approach is appropriate for any analysis of the  
7 fiduciary duties of a director under Delaware law.

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9 II. Plaintiffs' Motion for Summary Judgment

10 Plaintiffs seek summary judgment on their fourth cause of  
11 action based on the preclusive effect of the Chancery Court  
12 judgment. Defendant contends that issue preclusion is  
13 inappropriate because the factual issues relevant to the fourth  
14 cause of action are not identical to those decided in the state-  
15 court action. This argument is unpersuasive.

16 This court having decided that Defendant is a "fiduciary" as a  
17 matter of law, the relevant fact question under section 523(a)(4)  
18 is whether his wrongful acts amounted to a "defalcation." The  
19 state court made detailed findings to the effect that Defendant  
20 consciously failed to take the minimum steps legally required of  
21 him as a director to protect corporate assets. These findings  
22 represent a finding of defalcation: Defendant, while acting in a  
23 fiduciary capacity was unable to account for property placed under

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25 <sup>1</sup> Lawrence T. Lasagna, Inc. v. Foster, 609 F.2d 392, 396 (9th  
26 Cir. 1979) (director of insolvent corporation organized under  
California law is fiduciary for purposes of section 35(a)(4),  
27 predecessor to section 523(a)(4)); Nahman v. Jacks (In re Jacks),  
266 B.R. 728, 737 (9th Cir. BAP 2001).

28 <sup>2</sup> Cantrell, 329 F.3d at 1127.

1 his charge, and the property was lost due to Defendant's failure to  
2 follow the instructions imposed upon him by law regarding the  
3 protection of that property. See Otto v. Niles (In re Niles), 106  
4 F.3d 1456, 1460-62 (9th Cir. 1997).

5                   **\*\*END OF MEMORANDUM\*\***

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